Nos. 22277, 22277A and 22277B

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 22277

ESTATE OF BERNARD H. STAUFFER, BONNIE H. STAUFFER, EXECUTRIX,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 22277A

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Respondent.

On Petitions for Review of the Decisions of the Tax Court of the United States.

PETITIONER'S OPENING BRIEF.

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OPINION BELOW.

These are consolidated appeals from decisions of the Tax Court of the United States (Raum, J.) before

which Court the proceedings were consolidated. The findings of fact and opinion of the Tax Court of the United States are reproduced at pages 180-242 of the Record and are reported at 48 T.C. 277.

JURISDICTION.

Each appeal involves liability for income taxes imposed under Chapter 1, Subtitle A, of the Internal Revenue Code of 1954, for fiscal years ended January 31, 1958, January 31, 1959, and the eight month period ended September 30, 1959 in the case of Stauffer Reducing, Inc. of California, and for the eight month period ended September 30, 1959 in the case of Stauffer Reducing, Inc. (Illinois) and Stauffer Reducing, Inc. of New York. The petition for review was filed September 5, 1967 in each case [Record, pp. 252-261], pursuant to Section 7482 of the Internal Revenue Code.

SUMMARY STATEMENT OF THE CASE.

These cases involve the ultimate issue of whether a disastrous operating loss of Petitioner's business may be carried back against earlier profits of that same business under identical ownership. Although such carryback right is normally available under such circumstances, the Tax Court opinion holds that in the instant cases the carryback was completely forfeited because of the particular manner in which the states of incorporation of that business were moved to New Mexico.

The material facts contained in the Tax Court's findings of fact [Record, pp. 182-213] are not disputed by Petitioner. Substantially all of the facts were stipulated by the parties, and said stipulated facts, together with accompanying exhibits, are incorporated by reference in the findings of fact [Record, p. 182].

The basic facts and issues in the cases here at bar are as follows:

FACTS.

Prior to September 30, 1959, Bernard H. Stauffer was the sole stockholder of three corporations, each of which was engaged in the same business—the manufacture and sale of weight reducing apparatus [Record, pp. 185-6].

By far the largest of these corporations was Stauffer Reducing, Inc. of California, a California corporation ("Stauffer California"). It sold units in the Western United States, and, until 1958, did all of the manufacturing for the entire business operation. The second largest was Stauffer Reducing, Inc., an Illinois corporation ("Stauffer Illinois"), which sold the Stauffer products in the Mid-West, and, from 1958 on, did some of the manufacturing for the business. The third, and by far the smallest of the companies, was Stauffer Reducing, Inc. of New York, a New York corporation ("Stauffer New York"), which handled sales for the Northeastern United States [Record, pp. 185, 194, 196; Exs. 16-J, 19-M, 22-P].

In 1959, for bona fide business reasons, Stauffer California purchased land in Albuquerque, New Mexico, for the purpose of relocating the business in Albuquerque. It was also decided to relocate the operations of the Illinois and New York corporations in Albuquerque, and to combine the entire business operations into a single New Mexico corporation. All of the negotiations for the relocation of the business were conducted by Stauffer California, all of the Board of Directors' discussions (except for formal adoption of the merger)

relating the move were conducted by Stauffer California, and that corporation actually acquired the site to which the main office of the business was to be moved [Record, pp 188, 191].

To accomplish the relocations, Stauffer Laboratories, Inc., a New Mexico corporation ("Stauffer New Mexico"), was formed in August of 1959. On October 1, 1959 the three old companies reincorporated in New Mexico by means of a statutory merger with Stauffer New Mexico [Record, pp. 188-9].

There was no change in the business, method of operation, officers, directors or shareholders of the companies as a result of the reincorporation. Indeed, due to the business reverses described below, the plan to relocate the Stauffer business in New Mexico was never implemented, and the business continued to operate after the reincorporation precisely as before [Record, p. 191].

Pending a determination as to whether closing returns were required of the merged companies, requests for extensions of time were filed and estimated tax payments totaling $507,500 were made on December 15, 1959. No closing returns were in fact filed, pursuant to a determination that the reincorporation constituted an "F" reorganization. A return was filed by Stauffer New Mexico at the close of its fiscal year ending January 31, 1960, which return included the income of the three merged companies through September 30, 1959, totaling about $1,500,000, and a loss of about $800,000 suffered by Stauffer New Mexico during the remaining four months of the fiscal year, resulting in taxable income for the entire year of about $700,000. This return was accepted by the Internal

Revenue Service substantially as filed, and a minor overassessment was refunded [Record, pp. 192-4].

The business continued to suffer catastrophic losses, and Stauffer New Mexico was liquidated at the end of the next fiscal year, January 31, 1961. Its final return showed a loss of $3,366,052. Pursuant to its claim that an "F" reorganization had occurred in 1959, Stauffer New Mexico filed a carryback claim, contending that it was entitled to carry back its losses against premerger income. This claim was filed under the so-called "quickie" refund procedure of Section 6411 of the Internal Revenue Code of 1954 (the "Code"), which directs the Government to make a refund within ninety days after the claim was filed, subject only to a limited review of the claim. The claim was allowed, and the amount of the carryback claim was refunded to Stauffer New Mexico. Subsequently, upon audit, the Government took the position that the reorganization was not an "F" reorganization, and therefore the carryback was improper. In addition, the earlier approval of the 1960 return was reversed, and deficiencies asserted on the ground that closing returns should have been filed by all of the companies at September 30, 1959 [Record, pp. 195-6, 198-9].

The notices of deficiency were issued to Bernard H. Stauffer, determining his liability as the ultimate transferee of the assets of Stauffer California, Stauffer Illinois, and Stauffer New York. Mr. Stauffer died after the issuance of said notices, and the petitions before the Tax Court were filed by his estate [Record, p. 183].

LEGAL QUESTIONS.

1. The "F" Reorganization Issue.

The two legal questions presented upon this appeal which relate to the "F" reorganization issue are: (a) whether the taxable year of each of the old companies was required to end at the time of the merger, with the consequence that each was obligated to file a closing return for the period February 1 through September 30, 1959, and (b) whether the net operating losses sustained by Stauffer New Mexico for its fiscal year ending January 31, 1961 could be carried back and applied against the premerger income of the old companies.

Under Section 381(b) of the Code, the carryback of the operating losses incurred by the successor corporation, Stauffer New Mexico is permitted against premerger income, provided the transaction qualified as an "F" reorganization.[1] An "F" reorganization is defined under Section 368(a)(1)(F) as "a mere change in identity, form, or place of organization, however effected."

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[1]Section 381(b) of the Code provides, in part, as follows:

"(b) Operating Rules. — Except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of section 368(a)(1)—

(1) The taxable year of the distributor or transferor corporation shall end on the date of distribution or transfer.

* * *

(3) The corporation acquiring property in a distribution or transfer described in subsection (a) shall not be entitled to carry back a net operating loss for a taxable year ending after the date of distribution or transfer to a taxable year of the distributor or transferor corporation."

Section 172(b) provides, in part, as follows:

"(b) Years To Which Loss May Be Carried.—

(A)(i) . . . a net operating loss for any taxable year ending after December 31, 1957, shall be a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss."

It is undisputed that an "F" reorganization may (and ordinarily does) also qualify under one of the other reorganization definitions.[2] Also, there is no dispute as to Petitioner's handling of its tax returns if the reincorporation here involved was an "F" reorganization. Further, it is not believed to be disputed that the reincorporation of each of the old companies, effected separately, would have constituted an "F' reorganization, and the carryback would have therefore been available. The legal question here involved is whether the combining of the three corporate entities at the same time that the reincorporation takes place operates to disqualify all transactions from the "F' reorganization provisions, with the result that the carryback right is forfeited. Thus, the issue is whether the facts here qualify as an "F" reorganization of any or all of the predecessor corporations.

2. The "Erroneous Assessment" Issue.

The remaining legal question presented upon this appeal relates to the so-called "erroneous assessment" issue. It stems from the fact that $1,695,125.30 of the amount claimed in this proceeding as constituting a deficiency of Stauffer California actually represents moneys refunded to Stauffer New Mexico in connection with the carryback claim filed by Stauffer New Mexico long after the merger. Stauffer New Mexico is not a party to this proceeding, and Petitioner has not in this proceeding been assessed as the transferee of a primary tax obligation of Stauffer New Mexico. Petitioner's contention is that under the Tax Court's holding Stauffer New Mexico must be regarded as an en-

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[2]Rev. Rul. 57-276, 1957-1 C.B. 126; Rev. Rul. 58-422, 1958-2 C.B. 145; Regs. § 1.381(b)-1(a)(2) (T.D. 6480 7/12/60).

tirely different taxpayer than Stauffer California, and that the refund was therefore paid to a corporate stranger to this proceeding. The legal question, therefore, is whether the refund paid to Stauffer New Mexico can properly be included as an element of the deficiency of Stauffer California for the fiscal years ending January 31, 1958 and 1959, respectively.

SPECIFICATION OF ERRORS.

The Tax Court of the United States erred:

1. In failing and refusing to hold and decide that the mergers of Stauffer California, Stauffer Illinois and Stauffer New York into Stauffer New Mexico constituted an "F" reorganization within the meaning of Section 368(a)(1)(F) of the Code, and that: (i) pursuant to Section 381(b)(1) of the Code, the taxable years of Stauffer California, Stauffer Illinois, and Stauffer New York did not end on October 1, 1959, the date of their merger into Stauffer New Mexico, and (ii) Stauffer New Mexico was entitled to carry back its operating loss of $3,366,052 for the fiscal year ended January 31, 1961 against the premerger income of Stauffer California, Stauffer Illinois, and Stauffer New York pursuant to Sections 381(b)(3) and 172 of the Code.

2. In the alternative, in failing and refusing to hold and decide that the merger of Stauffer California into Stauffer New Mexico was an "F" reorganization within the meaning of Section 368(a)(1)(F) of the Code, that said "F" reorganization occurred simultaneously with two "A" reorganizations involving Stauffer Illinois and Stauffer New Mexico, within the meaning of Section 368(a)(1)(A) of the Code, and that: (i) pursuant to Section 381(b)(1) of the Code,

the taxable year of Stauffer California did not end on October 1, 1959, the date of its merger into Stauffer New Mexico, and (ii) Stauffer New Mexico was entitled to carry back its operating loss of $3,366,052 for the fiscal year ended January 31, 1961 against the premerger income of Stauffer California pursuant to Sections 381(b)(3) and 172 of the Code.

3. In the alternative, in failing and refusing to hold and decide that the mergers of Stauffer California, Stauffer Illinois and Stauffer New York, respectively, into Stauffer New Mexico, constituted, in each case, an "F" reorganization within the meaning of Section 368(a)(1)(F) of the Code, and that: (i) pursuant to Section 381(b)(1) of the Code, the taxable years of Stauffer California, Stauffer Illinois, and Stauffer New York did not end on October 1, 1959, the date of their merger into Stauffer New Mexico and (ii) Stauffer New Mexico was entitled to carry back its operating loss of $3,366,052 for the fiscal year ended January 31, 1961 against the premerger income of Stauffer California, Stauffer Illinois and Stauffer New York pursuant to Sections 381(b)(3) and 172 of the Code.

4. In failing and refusing to hold and decide that the sum of $1,695,125.30 refunded to Stauffer New Mexico was not properly an element of the deficiency, determined under Section 6211 of the Code, of Stauffer California for the fiscal years ended January 31, 1958 and 1959.

5. In that its Opinion and Decisions are contrary to law.

6. In that its Opinion and Decisions are not supported by, but are contrary to, the findings of fact and the facts as stipulated by the parties.

SUMMARY OF ARGUMENT.

THE "F" REORGANIZATION ISSUE.

I.

Preliminary Statement.

A. The facts in this proceeding do not in any way involve tax avoidance motives or objectives.

B. The loss carryback contended for by Petitioner herein would have been undeniably available to Petitioner if the three merger transactions had not been accomplished at or about the same time. Thus, the factual situation herein is distinguishable from the factual situation in *Libson Shops v. Koehler* (1957), 353 U.S. 382, since in *Libson Shops* the loss carryovers would not have been available in the absence of the legal maneuvering.

C. The facts in this proceeding require a holding either that (1) the entire transaction was an "F" reorganization, (2) there was an "F" reorganization between Stauffer California, the dominant predecessor company, and Stauffer New Mexico, the successor company, or (3) each of the three mergers here involved constituted a separate "F" reorganization.

II.

The Tax Court's Decision Disregards the Intent of Congress in Enacting the Loss Carryback Provisions, and Completely Misconstrues the United States Supreme Court Holding in Libson Shops.

The Tax Court completely misconstrues the import of *Libson Shops.* The whole thrust of the Supreme Court's decision in *Libson Shops* was to reject the legal niceties of the corporate entities as controlling the availability of the loss, and instead, look to the purpose of

the carryover provisions. In *Libson Shops,* the taxpayer was attempting through legal maneuvering to secure the benefit of losses which would otherwise have not been available under the law. Exactly the reverse is true here. It is the Government who is denying a loss to the taxpayer which would have been undeniably available if the transaction had taken place in any other way.

III.

The Tax Court Has Not Only Repudiated All Authority Which Preceded Its Decision in the Cases at Bar, but Has Not Even Consistently Applied the Same Principles in Other Decisions Which It Has Handed Down in Recent Months.

A. In its most recent decision, *Casco Products Corp.* (1967), 49 T.C. No. 5, the Tax Court held, contrary to its holding herein, that since the loss carryback would have been available had the transaction been consummated in another manner, the Court would ignore the corporate formalities and permit the loss carryback.

B. In still another recent decision of the Tax Court, *Dunlap & Associates, Inc.* (1967), 47 T.C. 542, the Court, contrary to its holding herein, recognized the independence of three separate reorganizations occurring at or about the same time, and treated each reorganization as a separate reorganization for tax purposes.

IV.

The Authorities Are Unanimous That the Touchstone of an "F" Reorganization Is Continuity of Ownership and Business. In the Cases Here at Bar There Was Absolute Identity of Ownership and Business.

A. It is clear that all authorities preceding the decision here at bar have consistently regarded the dis-

tinguishing criteria of the "F" reorganization to be continuity of ownership and continuity of business activity.

B. In the cases at bar, there is no question but that all attributes of the Stauffer business remained the same before and after the reorganization, and that the reorganization was a mere change in identity, form, or place of organization, with no change in substance.

V.

Until the Cases at Bar, Respondent Uniformly Advocated the Position That the "F" Reorganization Provisions Should Be Interpreted Even More Broadly Than the Interpretation Contended for by Petitioner Herein.

A. Prior to the 1954 Code, the "F" reorganization provisions languished almost unnoticed because the other reorganization provisions were adequate to encompass virtually all reorganization transactions.

B. After the enactment of the 1954 Code the "F" reorganization provisions achieved new prominence, primarily because of the vigorous efforts of the Government in the so-called "liquidation-reincorporation" area to construe the "F" reorganization as broadly as possible as a "catch all" reorganization to cover a broad array of alleged "liquidation-reincorporation" situations.

C. The Government has advocated a broad interpretation of the "F" reorganization provisions in both its published rulings and in a number of litigated cases, and has urged a far broader construction of the "F" reorganization provisions than is contended for by Petitioner herein.

VI.

The Tax Court's Decision Erroneously Repudiated Its Own Holding in Pridemark, Inc., and Erroneously Rejected the Holding of the Fifth Circuit in Davant v. Commissioner.

A. In *Pridemark, Inc.* (1964), 42 T.C. 510, modified on other grounds (4th Cir. 1965), 345 F. 2d 35, involving facts indistinguishable from those involved here, the Tax Court properly held that the transaction constituted an "F" reorganization. That decision has been cited by the Tax Court with approval in a number of subsequent cases.

B. In *Davant v. Commissioner* (*sub. nom. South Texas Rice Warehouse Co.* (1965), 43 T.C. 540; aff'd. in part and rev'd. in part (5th Cir. 1966), 366 F. 2d 874, cert. den. 386 U.S. 1022), involving facts indistinguishable from those involved here, the Fifth Circuit properly held that the transaction constituted an "F" reorganization.

C. The Tax Court erroneously repudiated its decision in *Pridemark,* and erroneously rejected the Fifth Circuit decision in *Davant.*

VII.

The Contentions of the Respondent and the Holding of the Tax Court Are Diametrically Contrary to the Previous Ruling Policy of the Respondent, Which Ruling Policy Respondent Still Purports to Abide by and Reaffirm.

A. In Rev. Rul. 58-422, 1958-2 C.B. 145, involving facts indistinguishable from those involved here, excepting only that a parent and two subsidiaries were involved rather than three brother-sister corporations, the

Service ruled that a transaction, identical to that effected here, constituted an "F" reorganization as to the parent corporation there involved.

B. Although the Tax Court purports to distinguish Rev. Rul. 58-422, *supra,* on the grounds that a parent and two subsidiaries were there involved, it is clear that the same principles of law are applicable in the case of brother-sister corporations as are applicable in the case of parent-subsidiary corporations.

C. In attempting to distinguish Rev. Rul. 58-422, the Tax Court evidences a complete misapprehension of the *Libson Shops* decision and Rev. Rul. 59-359, 1959-2 C.B. 475, in which the Government laid out rules it would follow in implementing the *Libson Shops* decision.

VIII.

The Tax Court Erred in Refusing to Hold, in the Alternative, That (a) the Merger Between Stauffer California and Stauffer New Mexico Constituted an "F" Reorganization, or (b) Each of the Three Mergers Constituted an Independent "F" Reorganization.

A. The holdings of the Tax Court in *Pridemark, supra,* and the Fifth Circuit in *Davant, supra,* are correct and should be followed in the cases here at bar.

B. In the alternative, however, the rationale of Rev. Rul. 58-422 requires that the facts in this proceeding be deemed to be an "F" reorganization of Stauffer California into Stauffer New Mexico, accompanied by two "A" reorganizations (under Section 368(a)(1)-(A) of the Code) between Stauffer Illinois and Stauffer New York, respectively, and Stauffer New Mexico.

C. In the further alternative, the facts in this proceeding should properly be regarded as three separate "F" reorganizations.

D. Rev. Rul. 58-422 also involved a single merger agreement effecting three mergers, and there is no more reason to fragment the transactions in Rev. Rul. 58-422 than there is to fragment them in the cases here at bar.

E. Had the Government been asked to rule in the cases here at bar that the transaction amounted to an "F" reorganization as to Stauffer California, it is believed that the Government would have unquestionably so ruled upon the strength of Rev. Rul. 58-422.

F. The tax aspects of the transaction should not depend upon whether or not the taxpayer announced to the Service beforehand that the transaction was intended as an "F" reorganization.

G. Under the rationale of Rev. Rul. 58-422, it is unquestionable that Stauffer California, because of the fact that it had by far the most premerger profits, and was otherwise the dominant company, should be deemed to have participated in an "F" reorganization. Moreover, although the Tax Court refused to so hold, Stauffer California was the first of the companies to merge into Stauffer New Mexico.

H. The Tax Court holding in *Pridemark* and the Fifth Circuit holding in *Davant* properly interpret the law. Rev. Rul. 58-422 was adopted prior to the time that the Government fully thought through the "F" reorganization provisions in connection with its contentions in the "liquidation-reincorporation" area, and Rev. Rul. 58-422 is an unduly narrow construction of the law.

I. A narrower but alternative analysis is to regard the transactions as three separate "F" reorganizations, but even if this alternative were adopted. Petitioner has sufficiently traced postmerger losses and premerger income so as to be entitled to prevail herein.

J. In summary, Petitioner is entitled to prevail under any of the aforementioned alternative theories, and it is not actually necessary for this Court to choose between them in this proceeding.

K. The proper construction of the law cannot be found in meaningless semantical debate, but must be found by analyzing the purposes of the loss carryover and carryback provisions. Petitioner is the classic example of the reason for the loss carryback and carryover provisions and is manifestly entitled to prevail herein.

THE "ERRONEOUS ASSESSMENT" ISSUE.

I.

The Tax Court Erred in Permitting the "Erroneous Refund" Paid to Stauffer New Mexico to Be Included as an Element of the Deficiency of Stauffer California. Such Refund, Having Been Claimed by and Paid to Stauffer New Mexico, Must Be Recovered From Stauffer New Mexico.

The Tax Court improperly held that the $1,695,-125.30 refund claimed by and paid to Stauffer New Mexico constituted a portion of the deficiency of Stauffer California. This amount was never claimed by or refunded to Stauffer California, but rather was claimed by and refunded to Stauffer New Mexico. The Government must proceed against Stauffer New Mexico to recover this sum, which it has not done in this proceeding.

ARGUMENT.

THE "F" REORGANIZATION ISSUE.

I.

Preliminary Statement.

Before embarking upon the technical discussion of the "F" reorganization issue, we believe it will be helpful to the Court to set the issue in its proper perspective.

As this Court is no doubt well aware, the problem of trafficking in loss corporations has had a long and colorful history in the courts, and, at first blush, there may be a tendency by this Court to identify the issue involved in the cases here at bar with those situations. However, it will be readily apparent to this Court as soon as it has an opportunity to acquaint itself with this case that no such trafficking in loss corporations is even remotely involved in this proceeding.

Also, there may be some first-blush tendency by this Court, as the Tax Court has apparently done even after studying the issues, to identify the cases here at bar with other cases in which legal maneuvering was utilized in order to attempt to make losses available against profits which, in the absence of such legal maneuvering, would not have been available to offset said profits. The landmark decision in this regard is *Libson Shops, Inc. v. Koehler* (1957), 353 U.S. 382, which, as this Court will recall, involved an attempt by a taxpayer who owned some seventeen brother-sister corporations, some of which operated at a profit, and some of which operated at a loss, to combine the corporations via a statutory merger and thereby be in a

position to use the loss carryover from the loss corporations against the profits from the profit corporations.

The cases here at bar have none of these attributes. The loss carryback which is involved in these cases would have been undeniably available against the profits of Stauffer California, for example, under any of the following factual hypotheses:

1. A carryback would have been undeniably available had Stauffer New York and Stauffer Illinois merely merged into Stauffer California.[3]

2. The carryback would have been undeniably available had Stauffer California merely moved its place of incorporation from California to New Mexico.[3]

3. The carryback would have been undeniably available had Stauffer New York and Stauffer Illinois first been merged into Stauffer California, and then Stauffer California had moved its state of incorporation from California to New Mexico.[3]

4. The carryback would have been undeniably available had Stauffer California moved its state of incorporation to New Mexico, and thereafter Stauffer New York and Stauffer Illinois had merged into Stauffer California.[3]

Under the holding of the Tax Court this carryback, which would have been undeniably available under any of the above factual patterns, is forfeited merely because of the happenstance that the change in place of incorporation and merger were consummated at or about the same time.

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[3]The reasoning supporting this statement will be explained *infra* in this brief. See Footnote 21 and the text relating thereto.

Figuratively speaking, we submit that the taxpayer has been victimized by the old shell game. We submit that the pea, *i.e.*, the loss carryback, must be found under one shell or another, but the Government and the Tax Court, through conceptual legerdemain, have secreted it up their sleeve!

In short, Petitioner's contention is that the cases here at bar necessarily fit within one of the following alternative analyses:

1. Based upon prior court decisions, the facts should be viewed as one "F" reorganization in which all of the companies involved are parties to the reorganization.

2. In the alternative, based upon the published ruling position of the Service, the facts should be viewed as an "F" reorganization of the dominant predecessor company, Stauffer California, occurring in conjunction with two separate statutory mergers involving the other two predecessor companies.

3. In the alternative, assuming that a narrower rule were to be established than alternatives 1 or 2 above, the facts should be viewed as an "F" reorganization of each of the predecessor companies.

Although Petitioner believes that the first of the above mentioned alternatives is the proper view, it is not necessary in this proceeding for this Court to determine which of the three alternatives should be adopted, since, as will hereinafter be demonstrated. Petitioner is entitled to prevail herein under any of the above alternative theories.

II.

The Tax Court's Decision Disregards the Intent of Congress in Enacting the Loss Carryback Provisions, and Completely Misconstrues the United States Supreme Court Holding in Libson Shops.

In the light of the preliminary statement, the first logical area of inquiry is to determine what could have motivated the Tax Court to reach its conclusion that the loss is forfeited as a result of the combination of the three otherwise permissible transactions. The answer to this becomes evident from the portions of the Tax Court's opinion [Record, pp. 228-9], in which the Court envisions "unintended difficulties" in the administration of the law, and concludes [Record, p. 230] that in order to avoid such "unintended difficulties" the loss should be denied.

Perhaps the most distressing aspect of the Tax Court's decision is that, apart from a brief passage in which the Court misinterprets the *Libson Shops* holding [Record, pp. 226-7], the Court does not address itself to the purposes and intent of the loss carryback provisions. Instead, the Court's opinion relies upon a variety of frail legal and factual distinctions[4] to sup-

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[4]On page 44 of its opinion [Record, p. 223] the Court set forth a series of what it regarded as "significant" formalistic changes. We submit, however, that whether or not such formalistic changes could be regarded as having significance in some non-tax context of the law, they have no significance, and indeed are irrelevant, to a determination of the taxing law here involved. We submit that from a tax standpoint, what is significant is found in the following findings of the Court:

> ". . . Stauffer New Mexico's principal place of business was 1919 Vineburn Avenue, Los Angeles, California, which had previously served as the main office of Stauffer California and from which the affairs of all Stauffer enterprises had been guided and controlled. It continued to carry on the operations previously conducted by the old Stauffer

port its conclusion. It seems incongruous that an entire life's work of the decedent taxpayer is to be emasculated and his widow and children essentially bankrupted, all upon the basis of such frail distinctions, without any analysis of the purposes and intendment of the loss carryback provisions.

It is apparent from the Court's limited discussion of the *Libson Shops* decision that it completely miscon-

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> companies from the same locations and in the same manner as before the merger. The accounting record continued to be broken down as though the three old Stauffer companies were still in existence, except that no inter-company profits appeared on the books" [Record, p. 191].

On page 45 of its opinion [Record, p. 224] the Court professed to perceive some significance in the singular use of the word "corporation" in Section 202(c)(2) of the Revenue Act of 1921. We submit that such an exercise by the Court is a fruitless semantical excursion, since *all reorganization definitions are framed in the singular,* and thus the use of the singular yields no insight whatever into what is meant by the statutory test of a change in the identity or form of that corporation.

Moreover, if this grammatical debate were to be extended, we wish to respectfully point out to this Court that, read in full text, Section 202(c)(2) of the Revenue Act of 1921 is actually more favorable to Petitioner's contentions than it is to Respondent's. The full text is as follows:

> "When in the *reorganization of one or more corporations* a person receives in place of any stock or securities owned by him, stock or securities in *a corporation* a party to or resulting from such reorganization. *The word 'reorganization,' as used in this paragraph, includes* a merger or consolidation (including the acquisition by *one corporation* of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of *another corporation,* or of substantially all the properties of *another corporation*), recapitalization, or mere change in identity, form, or place of organization of *a corporation,* (however effected);" [Emphasis added].

As to the *Berghash* case cited by the Court at page 45 of its opinion [Record, p. 224], the use of the singular by the Court is equally unenlightening. The *Berghash* case only involved one corporation, and therefore the Court would have no occasion to concentrate on the plural expression. Indeed, from other passages which are quoted in Section VI of this brief, it is apparent that the *Berghash* case is favorable to Petitioner herein.

strued the import of that decision, and this, in turn, adversely affected its attitude toward the established law relating to "F" reorganizations. The Court [Record, pp. 226-7] discusses the *Libson Shops* decision as supporting its conclusion that Stauffer New Mexico cannot be regarded as the same taxpayer as its predecessors. In fact, however, the rationale of the *Libson Shops* decision is directly to the contrary. The very first thing that the Supreme Court did in the *Libson Shops* case was to reject the legal niceties of the corporate entities as controlling the availability of the loss. Instead, the Court looked to the basic purpose of the carryover provisions and held that the corporate formalities were totally irrelevant to the question as to whether the same taxpayer was involved. Under the Supreme Court's decision in *Libson Shops,* even the same corporate entity may not be the same "taxpayer", and therefore may not be entitled to utilize the loss incurred by that very same corporate entity.[5]

What concerned the Court in *Libson Shops* was the fact that the taxpayer was attempting by means of the

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[5]"Equally misplaced is petitioner's emphasis on the fact that since, in the instant case, the surviving corporation was the loss corporation, whereas in *Libson Shops* the loss corporations were merged into the surviving corporation, the principle of *Libson Shops* is inapplicable. We have considered this argument in the past and concluded that merely because the loss corporation survives to claim the carryover, that fact will not present a bar to the application of the reasoning in *Libson Shops. Frank IX & Sons irginia Corp.* [Dec. 27,871], 45 T.C. 533, 542 (1966), aff'd. [67-1 USTC ¶9369] 375 F.2d 867 (C.A. 3, 1967), certiorari denied .... U.S. .... (Oct. 16, 1967); *Julius Garfinckel & Co.* [Dec. 26,262], 40 T.C. 870, 877 (1963), aff'd. [64-2 USTC ¶9626] 355 F. 2d 744 (C.A. 2, 1964), certiorari denied 379 U.S. 962 (1965.)"

Consolidated-Hammer Dry Plate & Film Co. (1967), 49 T.C. No. 18, p. ....; CCH T.C. Reg. Dec. p. 2942, at pp. 2951-2.

merger transaction to offset losses of loss corporations against profits of other profit corporations, a feat which would not have been possible under the law in the absence of the merger transaction.[6]

As has already been pointed out above, however, the taxpayer here is not trying to offset losses that would not otherwise have been allowable under the law in the absence of the mergers. *Exactly the reverse is true!* It is the Government, supported by the Tax Court, who would deny a loss to the taxpayer which would have been undeniably available to the taxpayer not only if the mergers had not taken place, but more importantly, even if the mergers had taken place in any other way.[7]

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[6]"Those provisions were enacted to ameliorate the unduly drastic consequences of taxing income strictly on an annual basis. They were designed to permit a taxpayer to setoff its lean years against its lush years, and to strike something like an average taxable income computed over a period longer than one year [footnote omitted]. There is, however, no indication in their legislative history that these provisions were designed to permit the averaging of the premerger losses of one business with the post-merger income of some other business which had been operated and taxed separately before the merger. What history there is suggests that Congress primarily was concerned with the fluctuating income of a single business [footnote omitted]. * * * *

"In the present case, the 16 sales corporations, prior to the merger, chose to file separate income tax returns rather than to pool their income and losses by filing a consolidated return. . . . If petitioner is permitted to take a carry-over, the 16 sales businesses have acquired by merger an opportunity that they elected to forego when they chose not to file a consolidated return. * * * *

"We find nothing in those provisions which suggest that they should be construed to give a 'windfall' to a taxpayer who happens to have merged with other corporations. The purpose of these provisions is not to give a merged taxpayer a tax advantage over others who have not merged." *Libson Shops v. Koehler* (1957), 353 U.S. 382 at 386-7, 390.

[7]Any exception to this statement would have to be premised upon a totally unreasonable hypothesis, *e.g.,* that taxpayer would have elected to merge the other corporations into tiny Stauffer New York.

The essence of the Tax Court's decision is that the simultaneous combination of corporate transactions, each of which individually would have resulted in the availability of the carryback, results in the complete destruction and forfeiture of the carryback.

The entire efforts of the courts and the Congress in recent years have been dedicated to the proposition that the availability of loss carrybacks and carryovers should not be determined by corporate artificialities, but rather by the economic realities of the transaction. This is the whole point of the *Libson Shops* decision and a host of decisions which have followed it.[8] But even before *Libson Shops,* Congress itself, when enacting the 1954 Code, was intent upon the task of casting the statutory language to accomplish this end. As stated in the Senate Finance Committee Report (S. Rep. No. 1622, 83d Cong. 2d Sess. p. 52):

> "Present practice rests on court-made law which is uncertain and frequently contradictory. Your Committee agrees that whether or not the items carryover should be based upon economic realities rather than upon such artificialities as the legal form of the reorganization.
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[8]This Court has, of course, held that the *Libson Shops* decision is not applicable under the 1954 Code. *Maxwell Hardware Co. v. Commissioner* (9th Cir. 1965), 343 F.2d 713. However, the decision is not here being cited for the proposition that the precise issue involved in *Libson Shops* is applicable under the 1954 Code. What is here being asserted is that the fundamental rationale and philosophy of the case; namely, that the purpose of the loss carryover and carryback provisions should be implemented by the Courts irrespective of legal artificialities, is equally applicable under the 1954 Code. The Tax Court itself recognized the applicability of the *Libson Shops* rationale to the cases at bar, but it unfortunately misconstrued this rationale [Record, p. 227, fn. 7].

> "The new rules enable the successor corporation to step into the 'tax shoes' of its predecessor corporation without necessarily confirming to artificial legal requirements which now exist under court-made law."

Congress' action in 1954 in revamping the operating loss provisions in an effort to make economic realities rather than corporate formalities control the availability of the loss carrybacks predated and presaged the *Libson Shops* decision itself. In *Libson Shops,* the Supreme Court decided that the same legislative intent was equally applicable to the 1939 Code and undertook to apply it to overrule the "uncertain and frequently contradictory" court-made law under the 1939 Code. In so doing, the Supreme Court no doubt was aware of the practical difficulties which would ensue as a result of its decision, and the Court obviously felt that the inconvenience which might be caused in implementing the decision was immaterial to the proper interpretation of the statute.

III.

The Tax Court Has Not Only Repudiated All Authority Which Preceded Its Decision in the Cases at Bar, but Has Not Even Consistently Applied the Same Principles in Other Decisions Which It Has Handed Down in Recent Months.

Fifteen years of progress in interpreting the loss carryover and carryback provisions have been incomprehensibly ignored by the Tax Court in its decision. The Tax Court by its decision would have us revert once again to worshiping the tin god of corporate formalities, a doctrine which has universally been rejected since the advent of *Libson Shops* and the 1954 Code.

One of the strangest aspects of the Tax Court's decision is that it not only rejected or repudiated the authorities which preceded its decision,[9] but the Tax Court itself has not even consistently adhered to the fundamental rationale of its *Stauffer* decision in other decisions which it has rendered in recent months.[10]

The most recent decision of the Tax Court, *Casco Products Corp.* (1967), 49 T.C. No. 5, was filed October 24, 1967. There, P corporation owned 91% of the stock of S corporation, and in order to "freeze out" the 9% minority shareholders, P formed a new corporation, into which S was merged, thereby enabling S under local law to pay off the minority shareholders of S in cash. After the merger, the new corporation attempted to carry back losses of the new corporation against premerger profits of S. The Government thereupon took the position that the carryback was not allowable because the reorganization did not qualify as an "F" reorganization in view of the 9% shift in ownership. Even the Tax Court, however, recognized the inequity of denying the loss carryback. The Tax Court refused to be stampeded into an erroneous result by rigid adherence to the legal artificialities involved. Instead, it held that the new corporation was really a continuation of the old corporation, that the net effect of the transaction was a redemption of stock, and that corporate formalities would be ignored. It was as if a different court was talking than the one which de-

[9] These past authorities will be discussed in ensuing sections of this brief.

[10] As this Court is no doubt aware, the Tax Court also handed down another decision in accordance with *Stauffer* a few days after the *Stauffer* decision, *Associated Machine* (1967), 48 T.C. 318, and that case is also presently pending on appeal before this Court.

cided the *Stauffer* decision here at bar just a few months earlier. In *Casco Products* the Court stated (CCH T.C. Reg. Dec. pp. 2870-71):

"Thus, both parties invite us to engage in an interpretative exercise as to the scope of section 368(a)(1)(F) and the relationship between sections 381(b) and 172. We decline the invitation to attempt to navigate these treacherous shoals. See *Reef Corporation v. Commissioner* [66-2 USTC ¶9716], 368 F.2d 125 (C. A. 5, 1955), certiorari denied 386 U.S. 1018 affirming in part and reversing as to the 'F' reorganization issue a Memorandum Opinion of this Court [Dec. 27, 309(M)]; *Estate of Bernard H. Stauffer* [Dec. 28,497]; 48 T.C. 277 (1967), on appeal (C. A. 9, Sept. 5, 1967); *Associated Machine* [Dec. 28,501], 48 T.C. 318 (1967), on appeal (C. A. 9, Sept. 15, 1967); *Dunlap & Associates* [Dec. 28,354], 47 T.C. 542 (1967). Instead we take a different tack.

"*There is no question, and indeed, respondent so concedes, that if Old Casco had redeemed the shares of the minority shareholders and had continued in business the loss carryback would have clearly been available. As we see it, the circumstances herein should not produce a different result. To hold otherwise would be to exalt form over substance and to accord an unjustifiable vitality to the merger format which was admittedly adopted only as a 'legal technique.'* (Emphasis added).

* * *

> "Under these circumstances, the merger was a reorganization in form only and should consequently be ignored as such. What took place was a redemption of 9 percent of the Old Casco shares and no more. [footnote omitted]. Under the limited circumstances of this case, we hold that New Casco was simply a continuation of Old Casco and the loss carryback should have been allowed."

The holding of the Tax Court in the *Casco Products* case was eminently correct, but completely inconsistent with the rationale of the *Stauffer* decision here at bar, and this fact was obvious to Judge Raum (the author of the *Stauffer* decision), who dissented from the decision (along with four other Judges).

Still another recent decision of the Tax Court will further demonstrate the incongruity of the situation. *Dunlap & Associates, Inc.* (1967), 47 T.C. 542, was decided by the Tax Court on February 28, 1967, which date was several months before the *Stauffer* decision was rendered, but was well after the *Stauffer* cases had been taken under submission by the Court. In the *Dunlap* case, P, a New York corporation, owned a controlling interest, but less than 80%, in several other corporations. In connection with a proposed public offering of P stock, P was advised that in order to clear up the validity of certain previous corporate transactions it should create a new Delaware corporation and merge itself into the Delaware corporation, and that it should simultaneously acquire the minority interests in two of the corporations in which it owned a controlling in-

terest. On June 28, 1961, the new corporation made a tender offer to exchange its stock for the stock of the minority shareholders of the two corporations controlled by P, and its tender offer was accepted by all of the minority shareholders during the period June 29, 1961 through July 7, 1961. The merger of P into the new Delaware corporation was effected on June 30, 1961. The issue in the case was whether the merger transaction constituted an "F" reorganization. The Government took the position that the merger transaction was a reorganization separate and apart from the reorganizations involving the two controlled corporations, and that this merger transaction constituted not only an "A", but also an "F" reorganization. The taxpayer contended that the merger and the exchange of stock with the minority shareholders were all part and parcel of a single plan and should be viewed as a whole, and that, viewed as such, the transactions would not qualify as an "F" reorganization because of the change in proprietary interest due to the elimination of the minority shareholders. The Tax Court, which absolutely refused to consider such an approach in the *Stauffer* decision, had no difficulty whatsoever in the *Dunlap* case separating the one overall plan into its separate component parts, the Court stating as follows (pp. 550-551):

> "While it appears that the formation of the petitioner under the laws of Delaware, the merger of the New York corporation into it, and the acquisition by the petitioner of the stock of the sub-

> sidiaries were all contemplated from the beginning and were deemed necessary to a public stock offering, this does not estalish that all such actions were parts of a single transaction constituting one reorganization or one plan of reorganization.
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> * * * *
>
> "In our opinion it must be considered that the various acts accomplished involved more than one reorganization within the contemplation of the statute. The merger of the New York corporation into the petitioner constituted a separate reorganization under section 368(a)(1)(A) and (F), and the acquisitions of the minority interests in the subsidiaries constituted two separate reorganizations under section 368(a)(1)(B)."

The holding in the *Dunlap* case is a correct holding. The Court recognized the economic realities of the situation and refused to be led astray by the taxpayer's technical arguments. Fundamentally, the Court recognized that there is no reason why three independent reorganizations cannot occur at or about the same time, and whether such reorganizations should be treated from a tax standpoint as separate reorganizations or one reorganization should depend upon the economic realities of the situation and the purposes of the statutory language involved.

The *Dunlap* case cannot rationally be distinguished from the *Stauffer* decision; yet in the *Stauffer* decision the Tax Court was content to dismiss the case in a footnote as "distinguishable." [Record, p. 233, fn. 9].

IV.

The Authorities Are Unanimous That the Touchstone of an "F" Reorganization Is Continuity of Ownership and Business. In the Cases Here at Bar There Was Absolute Identity of Ownership and Business.

Although, for reasons to be more fully explored in the next section of this brief, there is a relative paucity of authorities interpreting the "F" reorganization provisions, it is clear that all authorities preceding the decision here at bar have consistently regarded the distinguishing criteria of the "F" reorganization to be continuity of ownership and continuity of business activity. In *Ahles Realty Corporation v. Commissioner* (2nd Cir. 1934), 71 F. 2d 150, an "F" reorganization was described, at page 151, thusly:

> "When this transaction was completed, it was found that the sole stockholder of the old, the sole stockholder of the new, had a 100 per cent control over and interest in the identical assets * * *
>
> "There was a continuity of interest in the transaction, a continuance of the business conducted by the old corporation under the modified corporate form. After reorganization, the sole stockholder became the sole stockholder of the new, and the new corporation at completion was possessed of the same assets as the old * * * [I]t was 'a mere change in identity, form, or place of organization, however effected.' "

The same rationale was applied in *George Whittell & Co.* (1936), 34 B.T.A. 1070, and in *Helvering v.*

Southwest Consolidated Corp. (1946), 315 U.S. 194, at pp. 202-3, where the Supreme Court stated:

> "And a transaction which shifts the ownership of the proprietary interest in a corporation is hardly a 'mere change in identity, form or place of organization' within the meaning of clause [F]."

The Tax Court has reaffirmed this principle in a number of recent decisions. *Pridemark, Inc.* (1964), 42 T.C. 510, modified on other grounds (4th Cir. 1965), 345 F. 2d 35; *Book Production Industries, Inc.* (1965), 24 T.C.M. 339; *Hyman H. Berghash* (1965), 43 T.C. 743, aff'd. (2d Cir. 1966), 361 F. 2d 257; *Reef Corporation* (1965), 24 T.C.M. 379, rev'd. (5th Cir. 1966), 368 F. 2d 125, cert. den. 386 U.S. 1018; *Turner Advertising of Kentucky, Inc.* (1966), 25 T.C.M. 532.

See also, *Newmarket Manufacturing Co. v. U.S.* (1st Cir. 1960), 233 F. 2d 492, 497; *F. C. Donovan, Inc. v. U.S.* (1st Cir. 1960), 261 F. 2d 470, 472.

The Internal Revenue Service has stated that an "F" reorganization occurs:

> ". . . in all cases where there is no change in the existing stockholders or change in the assets of the corporations involved."
>
> Rev. Rul. 58-422, 1958-2 C.B. 145, 146.

See also:

> Rev. Rul. 63-203, 1963-2 C.B. 580.

In the cases at bar, there is no question but that all of the attributes of the Stauffer business remained iden-

tically the same before and after the reorganization [Record, p. 191]:

(i) Mr. Stauffer was the owner of all of the stock of the business before and after the reorganization [Stip. 1, 8];

(ii) the directors of the business were identical before and after the reorganization [Stip. 11];

(iii) The officers of the business were identical before and after the reorganization [Stip. 11, 16];

(iv) The nature and operation of the business were identical before and after the reorganization [Record, p. 191].

Indeed, it is difficult to conceive of a closer identity of business before and after the reorganization, since the move to New Mexico was never implemented and thus the business remained exactly as before [Record, p. 191].

In short, there was absolutely no change in the business. The reorganization was a mere change in identity, form, or place of organization, with no change in substance, coming directly within the definition of an "F" reorganization set forth in every authority which has considered the question, excepting only the Tax Court below.

V.

Until the Cases at Bar, Respondent Uniformly Advocated the Position That the "F" Reorganization Provisions Should Be Interpreted Even More Broadly That the Interpretation Contended for by Petitioner Herein.

Although the "F" reorganization provisions have been in the Internal Revenue Code since 1921, they have languished almost unnoticed until the advent of the

1954 Code, simply because the other reorganization provisions were adequate to encompass virtually all reorganization transactions. After the enactment of the 1954 Code, however, the "F" reorganization provisions have achieved new prominence, primarily because of the vigorous efforts of the Government to apply the "F" reorganization provisions in the so-called "liquidation-reincorporation" area.[11]

Because of the difficulties under the 1954 Code of otherwise handling the "liquidation-reincorporation" situation,[12] the Internal Revenue Service has for many

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[11]The "liquidation-reincorporation" problem can arise in various contexts, but the essence of the problem involves an attempt to transfer the basic operating assets of a corporation to a related corporation (which may or may not be a newly formed corporation), and to dissolve the transferor corporation and distribute its liquid assets to its shareholders at capital gain rates. Several basic mechanical routes can be followed to achieve this end. The transferor corporation can sell its assets to the transferee corporation and then liquidate, or alternatively, the transferor corporation can first liquidate, and then the assets can be transferred by its shareholders to the transferee corporation. The argument in the "liquidation-reincorporation" area revolves around the question of whether the liquid assets received by the shareholders of the transferor corporation are entitled to be received on a capital gains basis, or whether distribution represents, in essence, a disguised dividend distributed as part and parcel of a reorganization transaction.

[12]Prior to the 1954 Code, the primary method of attack in the "liquidation-reincorporation" area was under the "D" reorganization provisions (Section 112(g)(1) of the Internal Revenue Code of 1939). Basically, the definition of a "D" reorganization under the 1939 Code encompassed any transfer of some or all of the assets of a corporation which was 80% controlled by the transferor corporation or any one or more of the shareholders of the transferor corporation. Under the 1954 Code, however, in order to accommodate the so-called "spin-off" provisions of Section 355, the definition of a "D" reorganization (Section 368(a)(1)(D)) was substantially narrowed in several respects. First, a requirement was added that in order to qualify as a "D" reorganization, substantially all of the assets of the transferor corporation must be transferred (Section 354(b)(1)(A)). Secondly, a requirement was added that in order to qualify as a "D" reorganization, stock, securities, and

years vigorously espoused the position that the "F" reorganization provisions should be construed very broadly as a "catch-all" reorganization to cover a broad array of alleged "liquidation-reincorporation" situations. The Service's first published pronouncement of its broad interpretation of the "F" reorganization provisions was in Rev. Rul. 61-156, 1961-2 C.B. 62, in which the Service applied the "F" reorganization provisions to cover an alleged "reincorporation" of a business *even though there was a 55% change in stock ownership.* The factual situation in that ruling involved the sale of substantially all of the assets of the transferor corporation to a new corporation formed by the management of the selling corporation. The consideration for the sale of these assets consisted of 45% of the stock of the new corporation, plus cash and long-term notes. Immediately after the sale the remaining 55% of the stock of the new corporation was sold to the public. The selling corporation was then liquidated, and the shareholders of the selling corporation thereupon ended up owning 45% of the transferee corporation. The Service ruled this to be an "F" reorganization, stating as follows (at p. 64):

> "The newly formed 'purchasing' corporation was utilized to effect, in substance, a recapitalization and a change in identity, form, or place of organization of the 'selling' corporation and, at the same time, to withdraw accumulated earnings from the corporate enterprise for the benefit of the shareholders, while they nevertheless continued a substantial equity interest in the enterprise.
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other properties received by the transferor, as well as the other properties of the transferor, must be distributed in pursuance of the plan of reorganization (Section 354(b)(1)(B)).

> "In view of the foregoing, it is held that the transaction here described constitutes a reorganization within the meaning of sections 368(a)(1)(E) and (F) of the Code."

Since the issuance of Rev. Rul. 61-156, Respondent has aggressively pursued the principles therein stated in a number of litigated cases. Recent cases in which Respondent has so contended include *Joseph C. Gallagher* (1962), 39 T.C. 144; *Book Production Industries, Inc.* (1965), 24 T.C.M. 339; *Reef Corporation* (1965), 24 T.C.M. 379, aff'd. (5th Cir. 1966) 368 F. 2d 125, cert. den. 386 U.S. 1018; *Hyman H. Berghash* (1965), 43 T.C. 743, aff'd. (2d Cir. 1966) 361 F.2d 257; *Turner Advertising of Kentucky, Inc.* (1966), 25 T.C.M. 532.

In each of the above cases, Respondent argued for the broadest conceivable construction of the "F" reorganization provisions, contending that the "F" reorganization should even be extended to encompass substantial shifts in ownership. Although Respondent now professes to confess the error of his ways (but only as applied to the facts of this proceeding), one may legitimately wonder whether this confession of error may be motivated solely by the fact that it is to the Government's advantage to so confess error here. One may also wonder whether the Government will again reverse its field when it is convenient for the Government to do so.

VI.

The Tax Court's Decision Erroneously Repudiated Its Own Holding in Pridemark, Inc., and Erroneously Rejected the Holding of the Fifth Circuit in Davant v. Commissioner.

The Government's broad interpretation of the "F" reorganization provisions was adopted by the Tax Court in *Pridemark, Inc. supra.*[13] The *Pridemark* case involved facts which are indistinguishable from those involved here. There two (or possibly three) brother-sister corporations were liquidated and reincorporated into a single corporation which, the Tax Court found, continued to conduct the same business with no substantial change in ownership. The Tax Court held that the combination of these corporations constituted an "F" reorganization, concluding as follows:

> "That the net effect of the 1958 and 1959 transactions of Pridemark and Connecticut and their stockholders, was first to eliminate the unsatisfactory dealership relationship with Golden Key, and then to continue the business enterprise with a new manufacturing supplier under a modified corporate form through Pridemark Enterprises, with both continuity of ownership and continuity in the field of business activity;
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[13]On appeal to the Fourth Circuit, the factual conclusion of the Tax Court was reversed on the ground that "the new corporation cannot fairly be considered a continuation of the old business * * *" inasmuch as the old business had been transferred to an entirely unrelated company (345 F.2d 35, at p. 42).

> "That the above-mentioned transactions clearly fall within both the letter and the intent of section 368(a)(1)(F) of the 1954 Code, in that they constituted a 'mere change in identity, form, or [in the case of Connecticut] place of organization, however effected.' "

The principles enunciated in the *Pridemark* case remained undisturbed until the decision of the Tax Court in the cases at bar. Indeed, the Tax Court has referred to the *Pridemark* decision with approval in a number of cases. For example, in *Book Production Industries, Inc.* (1965), 24 T.C.M. 339, at p. 352, the Court stated:

> "In Pridemark, Inc., 42 T.C. 510, all of the 'essential operating assets' of the business of the old corporation (selling prefabricated houses) were carried over to the new corporation, which then continued this same business activity with a new manufacturing supplier. All of the stock of both the old and the new corporations was in the same hands. Under those facts we found 'both continuity of ownership and continuity in the field of business activity' and held that the transactions constituted a reorganization both within the letter and spirit of Section 368(a)(1)(F)."

Similarly, in *Hyman H. Berghash* (1965), *supra*, 43 T.C. 743, at pp. 753-754, the Court stated:

> "The respondent places considerable reliance on our recent decision in *Pridemark, Inc.*, 42 T.C. 510, on appeal (C.A. 4, Sept. 23, 1964). There three corporations that were controlled by the same individual were engaged in the business of selling prefabricated houses. Two were liquidated and

distributions of cash and other property were made to its shareholders. Just prior to the liquidation a new corporation was formed, the stock of which was issued to the same individual who had previously controlled the predecessor corporation. Subsequently he contributed to the new corporation a portion of the cash which had been distributed to him in liquidation. He also contributed a lease on certain office premises, together with a trade name 'Pridemark' and a business slogan, to the new corporation. The successor corporation continued to operate the same business as its predecessors had conducted and in the same location under the same name.

"We there held that the transaction qualified as 'a "mere change in identity, form, or place of organization" ' ".

* * *

"In the instant case there occurred a drastic shift in the proprietary interest of the owner of the predecessor corporation. . . . The situation before us, therefore, is distinguishable from *Pridemark, Inc., supra,* on a crucial point. Despite the fact that all of the operating assets were carried over to the successor corporation, which continued exactly the same business, in the same location, as had been conducted by the predecessor, the radical shift in stock ownership which occurred precludes us from holding that the transaction amounted to no more than 'a mere change in identity, form, or place of organization' within the meaning of section 368(a)(1)(F)."

A more recent case in which the Government urged its broad interpretation of the "F" reorganization provisions upon the Tax Court was *Davant v. Commissioner* (*sub nom. South Texas Rice Warehouse Co.* (1965), 43 T.C. 540; aff'd. in part and rev'd. in part (5th Cir. 1966) 366 F. 2d 874, cert. den. 386 U.S. 1022). *Davant* involved two brother-sister corporations, "Warehouse" and "Water", each with identical shareholders, and each in a separate, active business. The assets of one of the corporations, Warehouse, were transferred (via an intermediary) to the other corporation, Water, without any change in ownership, and thus the two businesses and corporations were fused into a single corporation with no change in ownership. In the process, however, $900,000 was distributed to the shareholders, and the issue in the case was whether the transactions amounted to a reorganization, with the result that the $900,000 distributed to the shareholders would be a dividend.

The Government argued to the Tax Court that the effect of the transaction was both a "D" and an "F" reorganization. The Tax Court held that the transactions constituted a "D" reorganization, with the result that the Court did not find it necessary to address itself to the "F" reorganization argument. By the time the *Davant* case came up on appeal, the Government no doubt realized that the arguments which it had been making in *Davant* and in other cases were totally inconsistent with the more advantageous posture it was taking in the Stauffer situation. As a result, the Government quietly jettisoned its "F" reorganization argument on appeal. However, the Fifth Circuit observed that the Government had argued the applicability of the "F" reorganization provisions be-

fore the Tax Court and adopted the "F" reorganization argument of the Government as its primary basis of holding on appeal. The relevant portions of the Fifth Circuit opinion, which aptly summarize Petitioner's position herein, are succinct enough to be reproduced here in their entirety (at pp. 883-4):

> "Since this interchange of events cannot be viewed as a complete liquidation, we must now decide, for the purposes of the federal tax code, what it is. In the Tax Court the Government contended that this was a 368(a)(1)(D) or (F) reorganization.
>
> "A section 368(a)(1)(F) reorganization is defined as 'a mere change in identity, form, or place of organization, however effected.' Since the Tax Court held that this transaction was a (D) reorganization, it apparently believed that it was unnecessary to decide the (F) question. In the past, type (F) reorganizations have overlapped with type (A), (C) and (D) reorganizations. For this reason this provision has received almost no administrative or judicial attention. It is true that a substantial shift in the proprietary interest in a corporation accompanying a reorganization can hardly be characterized as a mere change in identity or form. *Helvering v. Southwest Consolidated Corp.*, 315 U.S. 194 (1942).
>
> *"The term 'mere change in identity [or] form' obviously refers to a situation which represents a mere change in <u>form</u> as opposed to a change in substance. Whatever the outer limits of section 368(a)(1)(F), it can clearly be applied where*

> *the corporate enterprise continues uninterrupted, except for a distribution of some liquid assets or cash. Under such circumstances, there is a change of corporate vehicles but not a change in substance.* If Water had no assets of its own prior to the transfer of Warehouse's operating assets to it, could we say that Water was any more than the alter ego of Warehouse? The answer is no. The fact that Water already had other assets that were vertically integrated with Warehouse's assets does not change the fact that Water was Warehouse's alter ego. Viewed in this way, it can make no practical difference whether the operating assets were held by Water or Warehouse, and a shift between them is a mere change in identity or form. At least where there is a complete identity of shareholders and their proprietary interests, as here, we hold that the type of transaction involved is a type (F) reorganization. (Single emphasis added.)

In its decision below, the Tax Court erroneously repudiated [Record, p. 231] its decision in *Pridemark,* and erroneously rejected [Record, p. 232] the Fifth Circuit decision in *Davant.*[14]

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[14]Some insight into the Court's thinking can perhaps be divined from the following statement of the Court in distinguishing the *Davant* case [Record, p. 231]: "Like *Pridemark,* this case [*Davant*] arose in the liquidation-reincorporation field, where it was to the Government's advantage to urge that there had been a tax-free reorganization." In essence, the Court appears to condone the Government's attitude that statutory construction depends upon whether or not such construction is to the Government's advantage.

VII.

The Contentions of the Respondent and the Holding of the Tax Court Are Diametrically Contrary to the Previous Ruling Policy of the Respondent, Which Ruling Policy Respondent Still Purports to Abide by and Reaffirm.

Although the Government professes that acceptance of the taxpayer's position in the cases at bar would result in dire complications in the administration and construction of the Code, and although the Government has successfully convinced the Tax Court of this position, the rulings of the Internal Revenue Service completely refute this position. This is apparent from an examination of Rev. Rul. 58-422, 1958-2 C.B. 145. There, three corporations—a parent and two subsidiary corporations—were merged in a single statutory merger (just as was done in the cases at bar), into a single successor corporation which was newly formed for that purpose under the laws of a different state. The Service ruled that the reorganization of the parent corporation was an "F" reorganization, stating as follows (at p. 146):

> "Revenue Ruling 57-276 [relating to 'F' reorganizations] is applicable in all cases where there is no change in the existing stockholders or change in the assets of the corporations involved. *In the instant case, the fact that the subsidiaries of the former parent were liquidated at the same time that the said parent reincorporated in a different state did not constitute a change in the stockholders or assets of the merged corporation. The stockholders of the former parent had the same equity in the surviving corporation as they had in the*

> *three old corporations, inasmuch as all of the assets of the three transferor corporations were held by the surviving corporation. . . .*
>
> * * *
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> "In view of the foregoing, it is held that the transaction in the instant case insofar as it relates to the transfer of the assets and liabilities of the parent to the new corporation, constitutes a reorganization within the meaning of Section 368(a)(1)(F) of the Code. . . ."[15] (Emphasis added).

Petitioner submits that Rev. Rul. 58-422 cannot be distinguished from the cases here at bar. The Tax Court, however, purports to distinguish Rev. Rul. 58-422 by stating [Record, p. 233] that:

> ". . . since the subsidiaries or their businesses were always under the same corporate umbrella of the parent, both before and after the reorganization, it is plain that the situation presented in the ruling is not the same as the one before us."

We respectfully submit that the purported distinction conjured up by the Tax Court is imaginary. There is no reason whatsoever to distinguish a combination of a parent and two subsidiaries from a combination of three brother-sister corporations. In both situations

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[15]This same position was reaffirmed by the Service's more recent ruling, Rev. Rul. 63-203, 1963-2 C.B. 580. There the facts were identical to those involved in Rev. Rul. 58-422 except that one of the subsidiaries was only 95% owned by the parent. The Service held (under a corresponding stamp tax provision) that the transaction did not constitute an "F" reorganization, relying exclusively on the effect of the minor change in ownership interest arising out of the issuance of shares in the new company to the former minority shareholders in a subsidiary. The ruling assumed that but for this shift of ownership, the combination of the three companies would have been an "F" reorganization.

there is a combination of three separate entities into one successor entity. Indeed, Petitioner would be hard pressed to even understand the attempted rationalization by the Tax Court were it not for further language of the Court in *Associated Machine* (1967), 48 T.C. 318 (appeal pending before this Court), which case involved the same issue as involved in the cases at bar. There the Court stated with respect to Rev. Rul. 58-422 (at pp. 329-30):

> "Petitioner also relies on three rulings of the respondent which, it is argued, authorize a carry-back of petitioner's loss to Machine Shop's taxable year 1959. Rev. Rul. 57-276, 1957-1 C.B. 126; Rev. Rul. 58-422, 1958-2, C.B. 145; and Rev. Rul. 66-284, I. R. B. 1966-39. However, petitioner has overlooked a number of basic distinctions. First of all, the rulings deal with parent-subsidiary situations while the petitioner here is the surviving corporation of a merger between brother-sister corporations. That this is a material difference from the point of view of loss carrybacks is clear from a careful reading of Rev. Rul. 59-395, 1959-2, C.B. 475. That is, a member of an affiliated group may file a consolidated return with its constituent corporations. If a consolidated return is filed, the carryback and carryover provisions of the law are available to the group. Regulations 1.1502-21(b) and 1.1502-79. However, since a direct chain of ownership between the corporations is required before they can file consolidated returns, brother-sister corporations, related only by a common owner, are not entitled to this privilege. The theory behind this distinction is that if a parent

and subsidiary can file a consolidated return and benefit from the carryback provisions of section 381(b), there is little reason to deny the same parent and subsidiary the right to effectuate the same thing in another way—by merging one into the other or both into a newly formed corporation. Brother-sister corporations, on the other hand, cannot file consolidated returns and therefore are not covered by these rulings."

The foregoing statements by the Tax Court make it evident that the Court is under an unfortunate misapprehension as to the status of the law. The whole point of the *Libson Shops* decision is exactly contrary to the Tax Court's statement of the law. If the theory behind Rev. Rul. 58-422 is that inasmuch as a parent and subsidiary could file a consolidated return, they should be entitled to all of the benefits of filing a consolidated return even though they elected not to do so, then the Supreme Court's view of the law in *Libson Shops* is precisely to the contrary:

> "In the present case, the 16 sales corporations, prior to the merger, chose to file separate income tax returns rather than pool their income and losses by filing a consolidated return. . . . If petitioner is permitted to take a carry-over, the 16 sales businesses have acquired by merger an opportunity that they elected to forego when they chose not to file a consolidated return."[16]

[16]While it is true that the Supreme Court was erroneous in its statement that the brother-sister corporations in the *Libson Shops* case could have filed consolidated returns, since such privilege is not available to brother-sister corporations, nonetheless the quoted language amply demonstrates what the decision of the Court would be had the consolidated return privilege been available.

The Tax Court further evidenced a total misapprehension as to the meaning and purpose of Rev. Rul. 59-395, 1952-2 C.B. 475. In Rev. Rul. 59-395 the Internal Revenue Service laid out rules it would follow in implementing the *Libson Shops* decision, which would govern the extent "to which any operating losses . . . may be carried back or carried over across the line of the corporate fusion after a statutory merger or consolidation. . . ." (1959-2 C.B. 475, at 476). After an introductory discussion of the *Libson Shops* decision, Rev. Rul. 59-395 proceeds as follows (at pp. 478-479):

> "While on the basis of the particular facts before it in the Libson case a carry-over of a net operating loss was there denied, it is the opinion of the Internal Revenue Service that, in view of the principles enunciated and the decisions cited by the Court in that case, a different result would be warranted under the 1939 Code where a carry-over across the line of a statutory merger would result in application of either the premerger losses or unused excess profits credits of an absorbed constituent corporation to offset income derived by the resultant corporation from the same business by which the loss was sustained or the credit acquired. *For the same reasons, carry-backs of net operating losses and unused excess profits credits of the resultant corporation attributable to absorbed constituent corporations would appear to be properly allowable, to the extent that they offset premerger income of such constituent corporations, in determining the tax liability to which the resultant corporation has succeeded.* These conclusions would seem also to be applicable with re-

spect to consolidations. See *Helvering v. Metropolitan Edison Company,* 306 U.S. 522, Ct. D. 1392, C.B. 1939-1 (Part 1), 229, in which, and in cases referred to therein, carry-overs of tax rights across the line of statutory corporate fusions were allowed without apparent regard to whether such statutory fusions were mergers or consolidations.

* * *

"Accordingly, absent any evasion or avoidance of tax within the purview of section 129 or other provisions of the 1939 Code, with respect to statutory mergers and consolidations the tax treatment of which is determined under such code, *it is held that . . . (2) the portion of the net operating losses and unused excess profits credits attributable to the assets acquired by the resultant corporation from an absorbed constituent and used in continuing the prefusion business of such absorbed constituent may be carried back, to the extent that they offset the prefusion income of the absorbed constituent, in determining, the tax liability to which the resultant corporation has succeeded;"* (Emphasis added).

In short, in Rev. Rul. 59-395 the Service ruled that in any statutory merger or consolidation, irrespective of the number of corporations involved or whether the corporations were brother-sister, parent-subsidiary, or for that matter, totally unrelated, postmerger losses could be carried back against prefusion income of the absorbed constituent corporations to the extent that the loss arose out of the same business conducted prior to the reorganization.

Thus, in Rev. Rul. 59-395 the Service ruled that, under the 1939 Code, the losses involved in a case such as those at bar could have been carried back in the manner contended for by Petitioner herein. Further elaboration in this regard will be made in the next section of this brief, but Petitioner desires to also emphasize this fact at this time since the Tax Court has evidenced such a grievous misapprehension of the ruling.

VIII.

The Tax Court Erred in Refusing to Hold, in the Alternative, That (a) the Merger Between Stauffer California and Stauffer New Mexico Constituted an "F" Reorganization, or (b) Each of the Three Mergers Constituted an Independent "F" Reorganization.

As heretofore observed, Petitioner contends, as it did before the Tax Court, that the holdings of the Tax Court in *Pridemark* and the Fifth Circuit in *Davant* are correct and should be followed in the cases here at bar. However, in the alternative, Petitioner contends, as it did before the Tax Court, than in any event, the rule of the Respondent in Rev. Rul. 58-422 properly requires that the facts here at bar be deemed to constitute an "F" reorganization of Stauffer California into Stauffer New Mexico, accompanied by two "A" reorganizations (under Section 368(a)(1)(A) of the Code) between Stauffer Illinois and Stauffer New York, respectively, and Stauffer New Mexico. In the further alternative, Petitioner contends, as it did before the Tax Court, that if the court decisions in *Pridemark* and *Davant,* and Respondent's ruling in Rev. Rul. 58-422, are all to be disregarded, then the facts of the cases here at bar should be properly be regarded as three "F"

reorganizations involving Stauffer California, Stauffer Illinois and Stauffer New York, respectively, and Stauffer New Mexico. The Tax Court summarily rejected each of the alternative contentions by Petitioner in the following language [Record, p. 234]:

> "Thus, the three old Stauffer companies merged into Stauffer New Mexico not *seriatim* but simultaneously. Either all three were parties to the 'F' reorganization or none were. The three mergers were interdependent. They cannot be fragmented, nor can one of them be singled out as an 'F' reorganization as was possible in the case of the parent corporation in Rev. Rul. 58-422."

Petitioner respectfully submits to this Court that the merger transactions in Rev. Rul. 58-422 were also effected simultaneously by the same merger document, as the Tax Court found was true here. There is no more reason to fragment the transactions in Rev. Rul. 58-422 than there is to fragment them in the cases here at bar. We further respectfully submit to this Court that, as pointed out earlier in this brief in discussing the recent *Dunlap & Associates, Inc.* case, the Tax Court has no difficulty in so fragmenting a transaction when it desires to do so, and the Internal Revenue Service obviously has no difficulty in so fragmenting a transaction when it desires to do so, as is evident from Rev. Rul. 58-422 and Rev. Rul. 59-395.

Notwithstanding the efforts by the Government and the Tax Court to obfuscate the issue, the real meaning of Rev. Rul. 58-422 is perfectly obvious. The taxpayer in Rev. Rul. 58-422 approached the Service with a very simple problem. He wanted to change the place of in-

corporation of his three corporations, and he also wanted to combine them into one corporation. It was much simpler to effect this objective in one statutory merger than it was to effect it by means of three separate transactions. Accordingly, he asked the Service to rule that combining the three transactions into one statutory merger would not affect the essence of the transaction.

The Service very sensibly ruled that there was no reason whatsoever why the taxpayer could not accomplish his three objectives in one step, and thus the Service issued the requested ruling. However, the Service was no doubt concerned about possible administrative complications which might arise if it considered the entire transaction to be an "F" reorganization, whereas the taxpayer was no doubt unconcerned whether the whole transaction was treated as an "F" reorganization or merely the reincorporation of the parent was treated as an "F" reorganization. Accordingly, the Service ruled that the transaction would be viewed as an "F" reorganization of the parent corporation and a tax-free liquidation of the subsidiary corporations.

It is important to note that even though the Service ruled that the transaction was an "F" reorganization only as to the parent corporation, the effect of this ruling was to permit all operating losses incurred by the successor corporation after the merger to be carried back against the premerger profits of the parent, irrespective of whether these operating losses were generated by the business formerly conducted by the parent, or were generated by the businesses formerly conducted by the subsidiaries. It is further important to recognize that there was nothing wrong in permitting

such a carryback of the postmerger losses of the successor corporation, irrespective of which of the three businesses created these losses, since this same objective could have been easily and undeniably accomplished had the taxpayer effected the merger transaction in several steps rather than in one merger transaction.[17]

The fact that a parent and two subsidiaries were involved in Rev. Rul. 58-422 was, we submit, entirely irrelevant to the problem. Exactly the same analysis would have been applied by the Service if the corporations involved had been brother-sister corporations.[18]

Why, then, does the Government insist upon denying similar treatment to the taxpayer in the cases here at bar? Assuming that the Government is not simply motivated by a desire to unjustly enrich the coffers of the Government, the answer to this can only be found in the fact that the taxpayer did not ask the Service before the transaction to rule on the "F" reorganization issue. Had the Government been asked to rule that the transaction amounted to an "F" reorganization as to Stauffer California, we submit that the Service would have unquestionably so ruled upon the strength of Rev. Rul. 58-422. To deny such a ruling to the taxpayer would have made no sense, since the taxpayer could then have effected the transaction in a number of other ways, any of which would have unquestionably accomplished the intended result.

The Government and the Tax Court seemingly read some malevolent motive in the fact that the taxpayer did request a ruling from the Service prior to the trans-

[17]See footnote 21, *infra*, and text relating thereto.

[18]See discussion in preceding section of this brief. Also, this point will be further developed *infra* in this section.

action, but only requested an "A" reorganization ruling, and not an "F" reorganization ruling. However, it is evident that the disastrous operating losses were wholly unanticipated and thus there was no purpose in requesting an "F" reorganization ruling, since the transaction also qualified as an "A" reorganization. The record amply demonstrates that the decedent taxpayer was running an immensely successful business prior to the merger. It is further obvious from the portions of the record dealing with the valuation of inventory question, a strictly factual issue which is not before this Court [see Record, pp. 201-13], that the decedent taxpayer completely failed to recognize, or stubbornly refused to recognize, that due to competitive factors and Governmental attacks, his business had been critically injured prior to the merger. Said record further shows that the decedent taxpayer kept the facts of the cataclysmic deterioration of his business a well kept secret. It is self-evident that if his counsel had been given any inkling of the possibility of substantial business reverses, the merger would not have taken place, and certainly would not have taken place without a supplementary ruling covering the "F" reorganization point.

The issue boils down, therefore, as to whether the tax aspects of the transaction here at bar should depend upon whether or not the taxpayer announced to the Service beforehand that the transaction was intended to be an "F" reorganization. This, of course, cannot be.

But, says the Government, how do we know which of the three corporations the taxpayer intended to have the "F" reorganization with, unless the taxpayer announced his choice in advance? Again, the inference

is made that some malevolent objective can be accomplished unless the taxpayer is forced to announce his choice in advance. The Government reasons that if the taxpayer does not announce his choice in advance, he can retroactively pick which of the corporations he is to carry the losses back against. We submit that the Government is tilting windmills. First of all, at the date of merger the taxpayer would not even know that losess were going to be incurred. Secondly, if the taxpayer anticipated the possibility of losses, he probably would not be foolish enough to have entered into the merger. Thirdly, even if the taxpayer had anticipated that losses were going to be incurred, and did proceed with the merger, he would obviously have picked the company with the largest premerger profits to be the subject of the "F" reorganization. Accordingly, there is no doubt whatsoever which corporation is the subject of the "F" reorganization.

Again, we pause to emphasize that there is nothing wrong whatsoever with carrying back the losses incurred after the merger. Congress intended that this carryback should be permitted, and the carryback is legally, morally, and philosophically proper under the law.

Setting aside the fact that the California corporation would be the obvious choice for the "F" reorganization because of the fact that it had by far the most premerger profits, the record also conclusively demonstrates that for a number of other reasons the California corporation is the only logical choice:

(a) Stauffer California Was the Dominant Company in the Overall Stauffer Business.

The old Stauffer companies were the outgrowth of a California partnership, all of the stock of which was

owned by California residents. The home office of the overall business operation was at 1919 Vineburn, Los Angeles, California. From that office all major management directives were issued [Record, pp. 185-7].

When Mr. Stauffer was approached with regard to the relocation of his business in New Mexico, the California company considered, planned and prepared for the proposed relocation. The other companies participated in the transaction only through adoption of formal resolutions making themselves parties to the plan of reorganization. It was Stauffer California which purchased the land in Albuqurque which was to serve as the site of the business following the proposed relocations [Record, pp. 187-8, 191].

(b) Stauffer California Was by Far the Largest of the Companies.

By any objective standard Stauffer California was by far the largest of the three predecessor companies. For example, for the last fiscal year ended January 31, 1959, the tax returns of the respective companies [Ex. 16-J, 19-M, 22-P] show:[19]

(i) Stauffer California had about 75% of the total sales of the three companies;

(ii) It had almost 90% of the net income of the three companies;

(iii) It had over 70% of the combined net worth.

(iv) It had about ⅔ of the gross assets.

[19]These comparisons will, of course, vary depending upon the year selected, but there can be no doubt as to the conclusion that Stauffer California was by far the largest of the companies. The year ended January 31, 1959 has been selected since it was the last full year of operation prior to the merger.

It should be noted in this regard that Regs. §1.381 (c)(4)-1(c)(2)(ii), dealing with the method of accounting to be utilized by the successor corporation in a tax-free transaction involving multiple corporations, provide that the company with the greatest gross assets and gross receipts will be deemed to be the dominant or controlling entity for this purpose, and, of course, Stauffer California would meet this test.

(c) Stauffer California Was the First of the Companies to Merge Into Stauffer New Mexico.

Although the Tax Court refused to so hold [Record, pp. 233-4], the evidence and findings of the Court [Record, p. 190] demonstrate Stauffer California was also the first of the companies to be merged. The Merger Agreement specifically contemplates three separate merger transactions [Ex. 7-A]. Under Paragraph 1 of the Merger Agreement it is provided that Stauffer California merge into Stauffer New Mexico, the merger to be effective upon the filing of the necessary papers with the governmental agencies of the states of New Mexico and California. Similarly, Paragraph 2 deals with the merger of Stauffer Illinois into Stauffer New Mexico, providing that that merger shall be effective upon the filing of the necessary documents with the governmental agencies of the states of New Mexico and Illinois. Paragraph 3 deals with the merger of New York and New Mexico.

Paragraph 6(E) of the Merger Agreement contemplates that the individual mergers would become effective at different times, defining the "effective date of the merger" as meaning "the effective date of the *last of the individual mergers* contemplated hereby to become effective if each thereof does not become ef-

fective on the same date, such single or latest date, as appropriate, being hereinafter referred to as the 'effective date of the merger' unless the context requires otherwise . . ."

As stipulated by the parties and found by the Tax Court [Record, p. 190], the Merger Agreement was filed in the office of the Secretary of State of the State of New Mexico early in the morning of October 1. The Merger Agreement had already been mailed to the Secretary of State of the State of California, and a telephone request for filing of the Agreement was made on the morning of October 1. Under California law, the filing was effective at that time.[20] Filing did not occur until 4:30 P.M. in the State of New York, and 5:00 P.M. in the State of Illinois.

Thus it is clear that, under the rationale of Rev. Rul. 58-422, Stauffer California must be deemed to have participated in an "F" reorganization since Stauffer California (i) had by far the most premerger profits, (ii) was otherwise in all respects the dominant company, and (iii) was the first of the companies to merge into Stauffer New Mexico.

We can anticipate, however, an anguished cry from the Government that the choice in other situations may not be as simple as it is in the cases here at bar. To such a cry, we would respond by saying that the courts have more than adequate ability to solve this problem if the occasion arises, and the inconvenience of facing up to this theoretical problem cannot conceivably justify the frustration of the statutory pur-

[20]An instrument is "filed" when it is deposited in the proper office, for the purpose of filing the same. *Edwards v. Grand* (1898), 121 Cal 254; *Cox v. Tyrone Power Enterprises* (1942), 49 Cal. App. 2d 383, 395.

poses nor can it conceivably justify the outrageous penalty which is being exacted from the taxpayer herein as a result of the Tax Court decision.

We submit that thers can be no doubt as to the applicability of Rev. Rul. 58-422 to the cases at bar. Actually, the only difficult aspect of Rev. Rul. 58-422 is trying to synthesize the holding of that ruling with the Government's position in the "liquidation-reincorporation" cases, and with the holdings of the Tax Court in *Pridemark* and the Fifth Circuit in *Davant*. Rev. Rul. 58-422, of course, adopts a somewhat narrower concept than that adopted by the Government and the Courts in the "liquidation-reincorporation" area, since Rev. Rul. 58-422 considers only one of the three corporations to be the participant in the "F" reorganization, whereas in the "liquidation-reincorporation" area all three corporations would be deemed to be parties to the "F" reorganization. As previously noted, the effect of Rev. Rul. 58-422 is to permit a carryback of postmerger losses irrespective of which of the three businesses incurred these losses, but to require that losses be carried back only against the profits of one of the three businesses.

It seems apparent that Rev. Rul. 58-422 was adopted prior to the time that the Government fully thought through the "F" reorganization provisions in connection with its contentions in the "liquidation-reincorporation" area, and that Rev. Rul. 58-422 is an unduly narrow construction of the law. The Tax Court holding in *Pridemark* and the Fifth Circuit in *Davant* properly interpret the law. The Government seemingly infers that there is something immoral in permitting the successor corporation to carry back postmerger losses against

profits of all of the predecessor corporations. We submit, however, that there is no such immorality in permitting this result, since an "F" reorganization requires a factual situation in which there has been no substantial change in business or ownership as a result of the reorganization. Under these circumstances, it is eminently reasonable to permit a carryback of the post-merger losses against profits of all of the predecessor corporations.

In actuality, the holding of the Tax Court merely penalizes the innocent and unwary. Any taxpayer who anticipates future losses and who desires to carry those losses back against the profits of more than one of his corporations can easily plan to accomplish this result. To illustrate: If a taxpayer owns corporations A and B and anticipates losses in B which he wishes to carry back against the profits of A, he simply merges B into A. If B has its own previous profits which he also wishes to carry the losses back against, he simply waits until B's losses are sufficient to offset the previous profits of B, and then merges B into A. If he also wishes to change the place of incorporation of the corporations, he simply does so either before or after the merger transaction. Through this elementary planning, the carrybacks would be unquestionably available.[21] Thus, the effect of the Tax Court decision is

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[21]If no change in the place of incorporation is made, but B is merely moved into A, the surviving corporate entity, A, can routinely carry back the loss pursuant to Section 172 of the Code. The fact that the loss might arise from the business formerly conducted by B is immaterial. Rev. Rul. 66-214, 1966-2 C.B. 98 (although this ruling involved carryovers, it would equally apply to carrybacks). If A's place of incorporation is changed by, for example, merging A into a newly formed corporation, C, incorporated in another state, and this is done either

(This footnote is continued on the next page)

to unnecessarily penalize the innocent, a result which obviously cannot be sound.

But setting aside the propriety of the holdings in *Pridemark* and *Davant,* and setting aside the holding of Rev. Rul. 58-422, there is a third, albeit narrower, approach to the facts herein, and that is to treat the three mergers as three separate "F" reorganizations. There is, of course, absolutely no reason why three "F" reorganizations cannot occur simultaneously and be analyzed as such. Such an analysis would meet the objective sought by the Courts in *Pridemark* and *Davant,* since the holdings of the Courts in those cases would not have changed one whit whether the transaction had been viewed as one "F" reorganization or three "F" reorganizations. However, the only advantage in viewing the transactions as three "F" reorganizations rather than one "F" reorganization would be if this Court were to consider that *Libson Shops* principles should be applied even under the 1954 Code in the case of carryback claims arising out of an "F" reorganization. Under this reasoning, the Court would limit the carryback to the premerger income of the same business, a rule which is narrower than the rule in *Pridemark* and *Davant,* or Rev. Rul. 58-422, but is certainly more sensible than requiring a complete forfeiture of the carryback. While Petitioner does not believe that the adoption of this narrow rule is the soundest position for this Court to take, since there is no reason to infer that Congress intended any such restriction, nonetheless, as a precaution, Petitioner has introduced suf-

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before or after the merger of B into A, the merger of A into C would constitute a classic "F" reorganization even under the Government's theory. Therefore, under Section 381(b)(3) of the Code, C would be entitled to the same carryback rights as A would have had in the absence of the merger.

ficient evidence before the Tax Court so that, under any reasonable interpretation of *Libson Shops* principles, the tracing of premerger income and postmerger losses has been established [Record, pp. 193-197]. Although the Tax Court notes that the breakdown of postmerger losses is in one respect "not strictly" comparable [Record, p. 197] with corresponding premerger income, we respectfully submit that the evidence is sufficient to satisfy the rationale of *Libson Shops,* were such rationale deemed to be applicable to the cases at bar.

IX.

Conclusion.

In summary, no matter which of the above alternative theories were deemed to be applicable, Petitioner is entitled to prevail herein. Petitioner's views as to the proper approach have been detailed earlier in this brief and will not be reiterated here. Inasmuch as Petitioner is entitled to prevail under any of the alternative theories, it is not actually necessary for this Court to make a choice as to which is the proper theory at this time. Indeed, since the move to New Mexico was never implemented, and thus the fusion which occurred was merely a conceptual legal fusion rather than an actual fusion, this Court need not even determine how it would hold if an actual fusion had occurred. Any of the legal theories outlined above can arguably be supported as a reasonable construction of the law. The one theory, however, that cannot be supported as a reasonable interpretation of the law is the theory adopted by the Tax Court in its decision below.

We do not deny that the Tax Court's decision is the most convenient solution to the issue here at bar. Ob-

viously, there can be no problems in administering the carryback if the carryback is not permitted. Neither do we deny that complications may conceivably arise in the event Petitioner prevails herein. We do, however, emphatically deny that the Tax Court's decision properly construes the law. We agree with the Tax Court that the Code is an "extraordinarily complex and sensitive instrument." [Record, p. 230]. We disagree, however, with the Court's myopic conclusion that the statute must be narrowly construed so as to avoid "unintended difficulties." [Record, p. 230]. We venture to say that there always have been and will always be "unintended difficulties" in administering a statutory scheme of such gigantic proportions.[22] Congress could

[22]We must also respectfully remind this Court that the courts often expend herculean efforts to stretch the literal language of the statutes in order to implement the intent of Congress. In short, the concept of "unintended difficulties" is a two-way street. Take, for example, the "liquidation-reincorporation" area, and the "unintended difficulties" which have been encountered in implementing the Congressional intent. Consider how mightily the courts are struggling to patch the statutory imperfections. The following language of the Fifth Circuit in the *Davant* case (at p. 887 fn. 27) is significant in this regard:

> "Petitioners have cited us to a number of cases where the courts have construed the reorganization provisions with strict literalness without regard to the fact that it defeated the purpose of the tax statute. Each time, Congress acted to close the judicially created loophole. *From this interchange of events, petitioner asks us to draw the conclusion that the courts should always permit tax evasion when a literal application of the Code will minimize tax consequences regardless of the true economic realities. We draw just the opposite conclusion. Having been consistently rebuked by Congress in this area whenever we departed from the inherent purpose of the statutory scheme, we should avoid making the same mistakes and, instead, utilize all our efforts to apply the Code as Congress intended.* The problem created for Congress if the courts adopt any other approach to the reorganization provisions is made painfully apparent by this litigation. The statute must be narrow enough to prevent sales being made to look

not conceivably have anticipated all of the legal and factual permutations and combinations. The proper construction of the statute cannot be found by a meaningless semantic debate, but must be found by analyzing the purpose of the loss carryover and carryback provisions. This purpose is eminently clear. As the Supreme Court so aptly stated in *Libson Shops* (at p. 386):

> "Those provisions were enacted to ameliorate the unduly drastic consequences of taxing income strictly on an annual basis. They were designed to permit a taxpayer to setoff its lean years against its lush years, and to strike something like an average taxable income over a period longer than one year. [Footnote omitted]."

Petitioner herein is the clasic example of the reason for the loss carryback and carryover provisions,[23] and is manifestly entitled to prevail herein.

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like reorganizations and broad enough to prevent reorganizations being made to look like sales. *Had the courts adhered to obvious legislative intent and not felt restricted to a literal and rather restrained interpretation, there would have been no necessity for Congress to enact the detailed, almost impossible to follow, complicated reorganization provisions which now confront us.* The rules could be simple: 1) those who genuinely participate in reorganizations would get the tax deferment Congress intended; 2) those who sell property or withdraw earnings would be taxed as Congress intended. *The considerations underlying the reorganization provisions were not cast in terms of form but of substance. Courts in performing their judicial duty must take notice of this fact. See Bazley v. Commissioner* [47-1 USTC ¶9288], 331 U.S. 737 (1947)." [Emphasis added].

[23]The language and holding of the First Circuit in *F.C. Donovan, Inc. v. U.S.* (1st Cir. 1960), 261 F.2d 470 is particularly appropriate here. F. C. Donovan, Inc. was engaged in merchandising leather at wholesale prior to 1945-46. It had a wholly-owned subsidiary, Plastic Products Co., engaged in the

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THE "ERRONEOUS ASSESSMENT" ISSUE.

I.

The Tax Court Erred in Permitting the "Erroneous Refund" Paid to Stauffer New Mexico to Be Included as an Element of the Deficiency of Stauffer California. Such Refund, Having Been Claimed by and Paid to Stauffer New Mexico, Must Be Recovered From Stauffer New Mexico.

The second major issue involved in this proceeding stems from the fact that $1,695,125.30[24] of the amount

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business of distributing plastic sheeting. In December, 1946, Plastic Products Co. was merged into its parent, in a transaction that did not constitute a statutory merger under Massachusetts law. The Board of Directors of each corporation merely approved an agreement that all assets of the subsidiary should be transferred to the parent and the subsidiary's stock canceled.

After the merger, the corporation sustained a net operating loss which it sought to carry back against premerger income of Plastic Products Co.

The Court allowed the loss carryback and approved their prior case of *Newmarket Manufacturing Co.* (*supra*) emphasizing the "economic business identity" between the surviving unit and the prior two units. In this regard the Court said (at p. 472):

> "The government argues, therefore, that the Newmarket case is not controlling here, where 'more than one business was involved.' But we thought we had made it clear enough in the Newmarket case what we took to be of paramount importance, that the *ownership and all other practically important attributes of the business* which suffered the loss in 1952 and the business which had earned income in the previous year were unchanged. This is also true in the present case. It was in that context that we referred to the congressional desire, in enacting the carry-back privilege, to bring stability to the tax burden of 'a business with alternating profit and loss.' (233 F.2d at page 497.) And we thought that the Congress must have had in mind, in this connection, the burden *not of an artificial legal entity* called a corporation *but* 'that of *the human beings doing business behind the corporate facade* and who, alone, actually feel the pinch of taxation'." [Emphasis added].

[24]Although the actual amount of the refund was $1,744,847, only $1,695,125.30 (*i.e.,* $1,481,653.05 for the fiscal year 1958, and $213,472.25 for the fiscal year 1959) is included in the

claimed in this proceeding to be a deficiency of Stauffer California actually represents moneys refunded to Stauffer New Mexico in connection with the carryback claim filed after the merger on its own behalf. Petitioner's contention in this regard is very simple. The money was refunded to Stauffer New Mexico. Stauffer New Mexico is not a party to this proceeding. Petitioner has not in this proceeding been assessed as the transferee of a primary tax obligation of Stauffer New Mexico. A refund paid to Stauffer New Mexico can only be asserted against Stauffer New Mexico. The Government has no right to include an erroneous refund paid to Stauffer New Mexico as a part of the deficiency[25] of Stauffer California which has been held to be an entirely different taxpayer than Stauffer New Mexico. In order for the amount of the refund to be a part of the deficiency of Stauffer California, the refund claim had to have been filed by or on behalf of Stauffer California, and it was not; it was filed by Stauffer New Mexico on its own behalf

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deficiency because a $49,721.70 assessment which had previously been paid was credited against the deficiency [Record, p. 241, fn. 13].

[25]Section 6211 of the Code provides, in part, as follows:

"Definition of a Deficiency.

(a) In General.— . . . the term 'deficiency' means the amount by which the tax imposed by subtitles A or B exceeds the excess of—

(1) the sum of

(A) The amount shown as the tax by the taxpayer upon his return, [over] . . .

(2) the amount of rebates, as defined in subsection (b)(2), made.

* * *

(b)(2) The term 'rebate' means so much of an abatement, credit, refund, or other repayment, as was made on the ground that the tax imposed by subtitles A or B was less than the excess of the amount specified in subsection (a)(1) over the rebates previously made."

Ex. 25-S] and the refund was made to Stauffer New Mexico on its own behalf [Exs. 26-T, 26-U].

In response to this contention, the Tax Court, which on the "F" reorganization issue had doggedly impaled the taxpayer upon a tenuous reed of legal technicalities, dismissed this contention as "without merit." The Court stated as follows [Record, p. 241]:

> "While it is quite true that Stauffer New Mexico cannot be regarded as the same taxpayer as Stauffer California under section 368(a)(1)(F), it was nevertheless the successor to Stauffer California as the result of a statutory merger under Section 368(a)(1)(A) and had full standing to apply for and receive a refund of Stauffer California's taxes. Rev. Rul. 54-17, 1954-1 C.B. 160. If such refund were erroneously made, as was the situation in this case, there resulted a deficiency in Stauffer California's taxes (not Stauffer New Mexico's taxes), which the Commissioner was entitled to collect from the ultimate transferee of Stauffer California's assets, namely, the petitioner herein. To be sure, the claim for refund should have identified Stauffer California as the taxpayer, but there was never any doubt that the refund sought and received related to taxes paid by Stauffer California. Stauffer New Mexico was not even in existence during the two fiscal years in question, and it is difficult to see how the Commissioner could have determined deficiencies against it in respect of the improper refund. When that refund was made, deficiencies arose in Stauffer California's taxes for its fiscal years 1958 and 1959.

> We hold that the Commissioner proceeded properly in determining the deficiencies and transferee liability herein."

Although it is perfectly true, as stated by the Tax Court. that Rev. Rul. 54-17 permits a successor corporation to claim a refund on behalf of its predecessor corporation which has overpaid its income taxes, Rev. Rul. 54-17 requires that any claim for refund on behalf of a predecessor corporation must be executed "in the name of, and on behalf of, the corporation which paid such taxes" and must file proper evidence establishing its successor status. This was not done. The refund claim filed by Stauffer New Mexico was filed in Stauffer New Mexico's own name, with absolutely no reference whatsoever to Stauffer California (or either of the other predecessor corporations) [Record, p. 198].

Further, although the Tax Court peremptorily concludes that the refund claim should be conclusively deemed to have been filed by Stauffer California, Section 381(b)(3) does not purport to give the right to a refund to Stauffer California. Section 381(b)(3) gives the right to carry back to the "corporation acquiring property in a distribution or transfer described in subsection (a)" (an "F" reorganization being one of the transactions described in said subsection (a)).[26] Thus, the right to a refund under the statute was vested in Stauffer New Mexico, not Stauffer California.

It is thus eminently clear that the refund paid to Stauffer New Mexico cannot lawfully be included as

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[26]See text of statute in footnote 1.

part of the deficiency of Stauffer California. Stauffer New Mexico was the only corporation entitled to a refund, and accordingly it could not possibly have filed a refund claim on behalf of Stauffer California. Moreover, Stauffer New Mexico did not attempt to file a claim on behalf of Stauffer California, and thus there is no basis whatsoever for imputing such an act to Stauffer New Mexico.[27]

The fallacy of the Tax Court's reasoning can also be demonstrated in still another way. It is undisputed that Petitioner is only liable in this proceeding as a "double" transferee, that is, as transferee of Stauffer New Mexico, which was, in turn, a transferee of Stauffer California. Thus, in order to hold Petitioner liable as a transferee of Stauffer New Mexico, as transferee, it is necessary to determine that Stauffer New Mexico is itself a transferee. The basis for transferee liability must be found in Section 6901(a)(1)(A) of the Code, which defines transferee liability as "the liability at law, or in equity, of a transferee of property."[28] It is axiomatic that in order for

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[27]It is further obvious from the statutory notice of deficiency [Record, pp. 120-123] that the Government fully intended to assess the refund paid to Stauffer New Mexico as a deficiency of Stauffer California, and thus the Government cannot claim that there was a mere error in identifying the party. This is no case of mere "misnomer." Respondent, having acted exactly as it intended to act, cannot justify its issuance of a statutory notice of transferee liability which asserts a deficiency against a taxpayer who, under the holding of the Tax Court, is manifestly not liable for any tax. Such an effort was made by the Government and rejected in *Wayne Body Corp.* (1931), 22 B.T.A. 404, 414-415 (Acq. X-2 C.B. 74) and in *Reef Corp.* (1965), 24 T.C.M. 379, 391-2, aff'd. (5th Cir. 1966), 368 F.2d 125; cert. den. 386 U.S. 1018.

[28]Section 6901(a) of the Code provides, in part, as follows:

"(a) Method of Collection.—The amounts of the following liabilities shall, except as hereinafter in this section

Stauffer New Mexico to have transferee liability, there must have been an obligation of Stauffer New Mexico, whether choate or inchoate, existent on the date of merger of Stauffer California into Stauffer New Mexcio. Under California law, the corporate existence of Stauffer California ceased on the date of merger.[29] It is obvious from the facts in this proceeding that the liability for the erroneous tax refund could not possibly have been an obligation, either choate or inchoate, of Stauffer California on the date of merger, since the liability stems solely from facts occurring long after the date of merger. The carryback claim originated from losses incurred by Stauffer New Mexico more than one year after the date of merger. At the time the losses were incurred and at the time the refund claim was filed there was no Stauffer California, Stauffer California having ceased to exist on the date of merger. To hold that Stauffer New Mexico is liable as a transferee under these facts is not conceptually possible. The refund claim could only have been filed by Stauffer New Mexico, the refund could only have been paid to Stauffer New Mexico. The remedy of the Government is to proceed against Stauffer New Mexico, and it cannot properly claim that the

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provided, be assessed, paid and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred:

(1) Income, estate and gift taxes.—

(a) Transferees.—The liability, at law or in equity, of a transferee of property—

(i) of a taxpayer in the case of a tax imposed by subtitle A (relating to income taxes), * * *"

[29]Section 4116 of the California Corporations Code provides in part as follows: "Upon merger or consolidation pursuant to this article, the separate existence of the constituent corporations ceases . . ."

erroneous refund was a part of the deficiency of Stauffer California.[30]

Respectfully submitted,

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[30]This Court should be made aware of the fact that the Government has various procedural techniques available for recapturing erroneous refunds In this proceeding, the Government is attempting to recoup the amount under the "deficiency" procedure provided for in Section 6211 of the Code (See footnote 25). However, the Government could have also proceeded under the "mathematical error" procedure provided for in Section 6213(b)(2) of the Code, which it did not. Section 6213 (b)(2) provides as follows:

> "(b)(2) Assessments Arising Out of Tentative Carryback Adjustments.—If the Secretary or his delegate determines that the amount applied, credited, or refunded under section 6411 is in excess of the overassessment attributable to the carryback with respect to which such amount was applied, credited, or refunded, he may assess the amount of the excess as a deficiency as if it were due to a mathematical error appearing on the return."

Further, the Government can commence an action for the recovery of the erroneous refund under Section 7405(b) of the Code. Section 7405(b) provides as follows:

> "(b) Refunds Otherwise Erroneous.—Any portion of a tax imposed by this title which has been erroneously refunded . . . may be recovered by civil action brought in the name of the United States."

In fact, the Government has such an action presently pending in the United States District Court for the Southern District of California, Central Division, Civil Action No. 66-663-AAH, United States of America, plaintiff, vs. Stauffer Reducing, Inc. of New York; Stauffer Reducing, Inc. of Illinois; Stauffer Reducing, Inc. of California; Stauffer Laboratories, Inc.; and Bonnie H. Stauffer, individually and as Executrix of the Estate of Bernard H. Stauffer, Deceased, defendants. That case is presently being held in abeyance pending the result of this proceeding.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

Norman B. Barker